12/16/80 B 4250-1

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Dec. 12, 1980

This week, market interest rates continued their sharp upward surge, with new record high levels being set virtually everywhere. To say that trading activity was thin and nervous would considerably understate the case. The attitude of market participants concerning a possible near-term drop in rates soured significantly, as the Federal Reserve on two occasions entered the market to drain reserves when the Federal funds rate showed signs of softening. Though rates on short-term money market instruments scored large increases over the week, arguably the most pessimistic reaction took place in the long-term markets. Ever since Treasury's new long bond was auctioned early in November, it has traded at a premium over par, but on Wednesday it dropped below par and by late Thursday had declined over five points in value compared to the week before. That lifted its yield to over 13%--a record. In this setting, actions by the Fed to meet seasonal reserve needs in the statement week starting Thursday were cold comfort to market participants, some of whom wondered about the possibility of another discount rate hike following close on the heels of the last.

Altogether, then, the market's frame of mind is not exactly positive, despite some paring back of rates that set in on Friday. The source of the current rate pressure is the recent increase of the money stock at rates well above the Fed's targets. Since the Fed has refused to accommodate that growth, upward rate pressure--abetted by increases in the discount rate--has been the result. In addition, the Fed has compounded the pressure through the pattern of its open market operations. At this time of the year, banks lose reserves as the public withdraws large amounts of currency for holiday buying; our projections are that banks will lose about $4 billion of reserves that way during December. Faced with these pressures, banks tend to bid aggressively for funds, and the Fed's unwillingness to provide permanent additions to reserves until last Wednesday's bill purchase amplified the uneasiness. This probably accounts for a portion of the large 4% spread of the funds rate over the discount rate (including the 3% supplement).

But these things too will pass. For one thing, there is no doubt that the current punitively high rate levels will soon slow the pace of economic activity--including money stock growth. That will put less pressure on the Fed, and thus on everyone else. In addition, as the first quarter begins, no banks will be subject to the 3% discount rate supplement, since they will not have borrowed during the quarter. With a "clean slate," they should be less averse to borrowing and thus somewhat less aggressive in bidding for funds. Similarly, during the January-February period, the holiday cash drain reverses, and banks tend to become flush with reserves. The Fed will drain the reserve excess, of course, but other things being equal, banks should still be less aggressive in the funds market, thus reducing pressure on rates.

We hold to our expectation that rates should decline within a month or two.

William C. Melton

Note: The full text of this letter is available to Telerate Subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	12/12/80 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.00%	19.00%	15.25%
Effective since	12/10/80		
Discount Rate at Federal Reserve Bank	13.00	13.00	12.00
Federal Funds	20.00	20.25	14.25
Repurchase Agreements	19.75	19.75	13.65
U.S. Treasury Issues			
Bills			
3 months	17.57	16.57	12.76
6 months	16.84	16.22	12.95
1 year	15.49	14.71	12.00
Coupons			
2 years	14.77	14.39	11.88
4 years	14.04	13.65	10.86
7 years	13.40	13.15	10.40
10 years	13.26	12.93	10.38
Long Bond	12.92	12.44	10.14
Negotiable Certificates of Deposit-Secondary Market			
1 month	20.90	18.50	14.00
3 months	20.50	18.45	13.95
6 months	18.55	17.15	13.85
1 year	15.50	15.00	12.50
Banker's Acceptances			
1 month	20.50	18.50	14.00
3 months	20.85	18.50	14.15
6 months	18.65	17.15	14.05
Eurodollar Deposits			
1 month	22.38	19.50	14.50
2 months	21.63	19.50	14.81
3 months	21.25	19.00	14.81
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	19.38	17.00	13.25
1 month	17.50	16.25	13.63
3 months	16.00	14.25	12.00
Bank Holding Companies			
1 month	20.25	17.50	13.75
Dealer Placed:			
3 months	20.00	17.50	13.75
New AA Corporate Utility Bond	15.25	14.50	11.85
Tax Exempt			
6 month Project Notes	8.75	8.00	6.05
1 year AAA Bond	8.00	7.50	NA
5 year AAA Bond	8.00	8.25	NA
20 year AAA Bond	9.75	9.85	6.70

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629